Katten
Katten Muchin Rosenman LLP

CORPORATE & FINANCIAL
WEEKLY DIGEST

March 4, 2011

BROKER DEALER

SEC Approves FINRA Rules Governing Guarantees, Carrying Agreements, Security Counts and Supervision of General Ledger Accounts

The Securities and Exchange Commission has approved new Financial Industry Regulatory Authority rules governing guarantees, carrying agreements, security counts and supervision of general ledger accounts for the consolidated FINRA Rulebook on an accelerated basis. According to SEC Release No. 34-63999, the proposed rules are intended to, in combination with other consolidated financial responsibility rules approved by the SEC, enhance FINRA's authority to effectively execute its financial and operational surveillance and examination programs. Consistent with the approach that FINRA has discussed in previous releases and notices, many of the requirements set forth in the proposed rules are substantially the same as requirements found in current rules and, where appropriate, are intended to apply only to carrying or clearing firms, or to firms that engage in certain specified activities. FINRA will announce the implementation date of the proposed rule changes in a regulatory notice to be published no later than 90 days following SEC approval.

Click here to read SEC Release No. 34-63999.

Please see "SEC Proposes Rules on Disclosure of Incentive-Based Compensation Arrangements" in **Investment Companies and Investment Advisers** below.

CFTC

CFTC Publishes Twelfth Series of Dodd-Frank Rules

The Commodity Futures Trading Commission has published its twelfth series of proposed rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act as well as a proposed interpretive order to give effect to the Dodd-Frank Act provisions relating to "disruptive" trading practices. The proposals relate to technical amendments to regulations governing commodity pool operator (CPO) and commodity trading advisor (CTA) registration; requirements for processing, clearing and transferring customer positions; and the intermediary registration requirements as they relate to swap dealers, major swap participants (MSPs) and swap execution facilities (SEFs).

- **Amendments to Regulations Regarding CPOs and CTAs:** The CFTC has proposed amendments to its existing Part 4 regulations, relating to CPOs and CTAs, in order to harmonize the provisions of Part 4 with the Dodd-Frank Act. The proposed rules would, among other things, define the term "commodity interest" to include, among other instruments, a swap and modify CTA and CPO disclosure, reporting, and recordkeeping requirements to include swap transactions and interaction with swap dealers.

- **Processing, Submission, Acceptance of Swaps, and Customer Position Transfers:** The CFTC has proposed regulations that would establish uniform standards for the prompt processing, submission and acceptance of swaps eligible for clearing by a derivatives clearing organization (DCO) and establish certain product standards for DCOs. The proposed regulations are additionally intended to facilitate the transfer of customer positions from one clearing member to another.

SEFs and designated contract markets (DCMs) would be required to submit swaps for clearing immediately upon execution. The proposed regulations further require (1) with respect to swaps that are not executed on a SEF or DCM but that are subject to mandatory clearing, that a swap dealer or MSP submit such swaps for clearing as soon as technologically practicable following execution, but not later than the close of business on the day of execution and (2) with respect to swaps not subject to mandatory clearing but which the parties agree to have cleared, that a swap dealer or MSP submit the swap for clearing not later than the next business day after execution.

The proposed regulations would also include timing requirements for the processing of swaps submitted to a DCO for clearing.

- If a swap is executed on a SEF or DCM, a DCO must accept the swap immediately upon execution.
- If a swap is not executed on a SEF or DCM, but is subject to mandatory clearing, the DCO must accept the swap upon its submission to the DCO.
- If a swap is not executed on a SEF or DCM, is not subject to mandatory clearing but is being submitted for clearing, the DCO must accept the swap no later than the close of the business day of submission to the DCO.

The proposed regulations would also require a DCO to establish templates for the terms and conditions of swaps that it will clear; to select contract unit sizes for swaps that maximize liquidity, open access and risk management; and to have rules stating that upon acceptance of a swap by the DCO for clearing, (1) the original swap is extinguished and (2) is replaced by equal and opposite swaps between clearing members and the DCO, (3) terms of the cleared swaps must conform to templates established under DCO rules, and (4) where a swap is cleared by a clearing member on behalf of a customer, all terms of the swap, as carried in the customer account on the books of the clearing member, must conform to the terms of the cleared swap established under the DCO's rules.

The CFTC is also proposing regulations that would require all swap dealers, MSPs, DCOs, SEFs and DCMs to coordinate with each other in developing rules and procedures that facilitate prompt and efficient swap processing.

The CFTC has further proposed to prohibit the DCOs from refusing to clear a swap if neither party to the transaction is a clearing member. The CFTC indicated that, in its view, a restriction of this nature serves no apparent risk management purpose and operates to keep certain trades out of the clearing process and to constrain liquidity for cleared trades.

Finally, the proposed regulations would require DCOs to establish rules for prompt transfers of all or a portion of a customer's portfolio of positions and related funds from one clearing member to another, upon the request of the customer and subject to the consent of the receiving clearing member, without requiring the close-out and re-booking of the positions prior to the requested transfer.

- **Registration of Intermediaries:** The CFTC has proposed to amend Part 3 of its regulations, which set forth registration requirements for intermediaries, to eliminate obsolete references to derivatives transaction execution facilities and to add references to swap dealers, MSPs and SEFs where appropriate. The CFTC proposal would also exempt an associated person of a swap dealer or MSP from individually having to register as a swap dealer or MSP.

  The proposed rules also would expand an existing exemption from the definition of "principal" to include foreign banks that are otherwise regulated and would create an exemption from registration as a futures commission merchant for foreign brokers and other foreign intermediaries that execute a transaction on a SEF on behalf of non-U.S. persons.

- **Antidisruptive Trading Authority:** The Dodd-Frank Act amended the Commodity Exchange Act to include a new Section 4c(a)(5), which prohibits any trading, practice or conduct on or subject to the rules of a registered entity that:

- violates bids or offers;
- demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or
- is of the character of, or is commonly known to the trade as, "spoofing" (bidding or offering with the intent to cancel the bid or offer before execution).

The CFTC has released a proposed interpretive order to provide further clarity as to the scope and interpretation of the Section 4c(a)(5) prohibitions.

With respect to the first prohibited activity, the proposed interpretive order would establish that violating bids or offers involves buying a contract at a price that is higher than the lowest available offer price and/or selling a contract at a price that is lower than the highest available bid price, regardless of intent. This prohibition would operate in any trading environment where a person exercises some control over the selection of the bids or offers against which they transact, including in an automated trading system which operates without pre-determined matching algorithms, but not in any automated trading system with a pre-determined matching algorithm (where it would be impossible to violate a bid or offer).

With respect to the second prohibited activity, the proposed interpretive order would establish that the scienter requirement included in the statute ("intentional or reckless") would preclude violations based on accidental or negligent trading conduct and practices. Furthermore, the proposed interpretation would provide for this purpose that the "closing period" is the period when the daily settlement price is determined under the rules of that trading facility.

Finally, the proposed order would interpret the prohibition as requiring that a person intend to cancel a bid or offer before execution (a scienter requirement). In the CFTC's view, the "spoofing" prohibition would not be implicated by reckless trading, conduct or practices or in the event of orders, modifications or cancellations submitted as part of a legitimate, good-faith attempt to consummate a trade. "Spoofing" would be interpreted, however, to include: (1) submitting or cancelling bids or offers to overload the quotation system of a registered entity; (2) submitting or cancelling bids or offers to delay another person's execution of trades; and (3) submitting or cancelling multiple bids or offers to create an appearance of false market depth.

Comments on the proposals are generally due within 60 days from the dates of their publication in the *Federal Register*. However, comments on the proposed rules regarding Processing, Submission, Acceptance of Swaps, and Customer Position Transfers are due 30 days from the date of their publication.

The proposed rules and interpretive order can be found here.
Further information regarding the proposals, including fact sheets and Q&As, is available here.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Proposes Rules on Disclosure of Incentive-Based Compensation Arrangements

As required by Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Securities and Exchange Commission has announced that it is proposing a rule applicable to broker-dealers and investment advisers with $1 billion or more in assets that would (1) require them to file annual reports with the SEC related to incentive-based compensation; (2) prohibit incentive-based compensation arrangements that encourage inappropriate risk-taking by providing excessive compensation or that could lead to material financial loss to the firm; (3) provide additional requirements for firms with $50 billion or more in assets, including deferral of incentive-based compensation of executive officers and approval of compensation for people whose job functions give them the ability to expose the firm to a substantial amount of risk; and (4) require them to develop policies and procedures that ensure and monitor compliance with requirements related to incentive-based compensation.

When announcing the proposed rule, SEC Chairman Mary Schapiro stated that she is particularly interested in commenters' views on (1) how assets would be calculated for purposes of determining whether institutions fall within either component of the proposed rule; (2) how the proposed rule might affect the broad array of financial firms covered by Section 956, including broker-dealers and advisers—most particularly private fund advisers, given how they often structure their compensation; and (3) the proposal's potential impact on broker-dealer and investment adviser business models and the variety of services they provide to investors.

Public comments on the rule proposal should be received within 45 days after it is published in the *Federal Register*. The full text of the proposed rule is not yet available.

For a copy of the SEC's press release, see here.
For a copy of SEC Chairman Mary Schapiro's remarks, see here.

LITIGATION

Dissatisfied Employees Unable to Recover Penalties from Investors under New York Law

A New York statute that requires a corporation's largest investors to guarantee employee wage payments does not require such investors to satisfy penalties owed workers under Indiana law.

Employees of Waste Reduction, Inc. sued the bankrupt company for overdue wages and penalties, as permitted under Indiana law, but were unable to recover their award for penalties because of the former firm's limited assets. Waste Reduction was incorporated in New York, however, which requires the 10 largest shareholders of a corporation to guarantee employee wages and benefits. The employees sued Waste Reduction's largest investors, arguing that New York law requires these investors to satisfy the penalties owed workers under Indiana law. The district court dismissed and appeal followed.

The U.S. Court of Appeals for the Seventh Circuit, in a matter of first impression, affirmed the district court's decision. Plaintiffs' claims improperly combined separate statutory directives, as New York law requires investors to satisfy corporate debts for services performed, while Indiana law imposes penalties for belated payments but does not demand that investors guarantee corporate debts. (*Whitely v. Moravec,* 2011 WL 523346 (7th Cir. 2011))

Argentine Instrumentality Not the Government's Alter Ego

An instrumentality of the Republic of Argentina could not be deemed the government's alter ego based on its role in implementing Argentina's energy policies and thus was not liable for the country's bond debts.

Argentina defaulted on $1.5 billion in bond payments but has few assets in the United States, which has forced creditors to look elsewhere for repayment. Creditor NML Capital, Ltd. sued Energia Argentina S.A. (ENARSA), an instrumentality of the Argentine government that plays a substantial role in enacting Argentina's energy policies but that has independent corporate status under Argentine law. NML argued that ENARSA is an alter ego of the government because the national government owns 96% of ENARSA shares, controls ENARSA regulations via government regulations, and provides ENARSA with substantial financial support through subsidies and other benefits.

The U.S. District Court for the Southern District of New York dismissed NML's claim, holding that Argentina's use of ENARSA to achieve its policy goals did not constitute the type of close management that constitutes an alter ego relationship and that Argentina's control of ENARSA was not deceitful. The court permitted NML to re-plead if it could show that the Argentine government directed ENARSA's daily operations. (*NML Capital, Ltd. v. The Republic of Argentina*, 2011 WL 524433 (S.D.N.Y. Feb. 15, 2011))

BANKING

Federal Reserve Issues Proposed Rule on Availability of Funds and Collection of Checks

The Federal Reserve Board on March 3 requested public comment on proposed amendments to Regulation CC (Availability of Funds and Collection of Checks) to encourage banks to clear and return checks electronically, add provisions that govern electronic items cleared through the check-collection system, and shorten the "exception" hold periods on deposited funds. To encourage electronic collection and return of checks between banks, the proposal provides that a depositary bank would be entitled to the expeditious return of a check only if it agrees to receive returned checks electronically. In addition, the proposal would permit the bank responsible for paying a check to require that checks presented to it for same-day settlement be presented electronically. More generally, the proposal would apply Regulation CC's collection and return provisions, including warranties, to electronic check images that meet certain requirements.

Additionally, due to the faster collection and return timeframes that result from electronic collection and return, the proposal would shorten the safe-harbor period for an exception hold to four business days, which should enable the depositary bank to learn of the return of virtually all unpaid checks before being required to make these deposits available for withdrawal. The proposal also eliminates the references in Regulation CC to "nonlocal" checks. The distinction between local and nonlocal checks is tied to Federal Reserve Bank check processing regions. (As of February 2010, the Reserve Banks ceased operations in all but one of their check processing offices, such that there is now only one check processing region, and all checks are local to each other. Local checks are generally subject to a two-business-day hold period.)

Appendix C to the regulation sets forth model funds-availability forms that banks may use as the basis of their disclosures to customers. According to the Federal Reserve, the proposal includes new model forms that were developed using consumer testing and that set forth funds-availability policies in a manner that is designed to be more easily understood by consumers.

Click here to read Regulation CC.
Click here to read more about the design and testing of Regulation CC, including Appendix C forms.

UK DEVELOPMENTS

FSA Announces DEPP Changes

On February 25, the UK Financial Services Authority (FSA) announced certain changes to its Decision Procedure and Penalties Guide and its Enforcement Guide and Policy.

With effect from March 6:

- Firms will be prohibited from paying any financial penalty imposed by the FSA on a present or former employee, director or partner of the firm or any affiliate.
- The FSA has changed its policy for publishing decision notices (as opposed to final notices). In certain circumstances decisions may now be published even though the defendant has referred the matter to the Upper Tribunal by way of appeal.
- The FSA will apply its "settlement discount scheme" to suspension periods as well as to financial penalties.

Read more.

FSA Hedge Fund Surveys' Conclusions Published

On February 28, the UK Financial Services Authority (FSA) produced its latest biannual report, "Assessing Possible Sources of Systemic Risk from Hedge Funds." This report sets out the FSA's key findings from two hedge fund surveys conducted in September and October 2010—its hedge funds as counterparties survey (HFACS) and its Hedge Funds Survey (HFS). The FSA conducts these surveys every six months to assist it in understanding potential sources of systemic risk in the hedge fund sector. (See the February 26, 2010, and August 13, 2010, editions of *Corporate and Financial Weekly Digest* for reports on previous HFS and HFACS.)

The February 2011 report's findings include the following:

- The "footprint" of surveyed hedge funds remains small within most markets and leverage is largely unchanged. Therefore, risks to financial stability through the hedge fund market channel seemed limited at the time of the latest surveys.
- Counterparties have increased margin requirements and tightened other conditions on their exposures to hedge funds, increasing their resilience to hedge fund defaults.
- Some risks to hedge funds remain, particularly if they are unable to manage a sudden withdrawal of liabilities during a crisis period.
- Counterparty credit exposures to hedge funds remain concentrated among a small number of banks.

The FSA stated that it intends to repeat the HFS and HFACS in March 2011. It also intends to work closely with the International Organization of Securities Commissions and other national regulators on a global approach to systemic risk data requirements for hedge funds.

Read more.

EU DEVELOPMENTS

EC Publishes Financial Services Legislative Agenda

On February 25, the European Commission published an updated agenda and timetable for financial services legislative proposals including the following:

- Securities Law Directive, expected to be adopted in May 2011
- Recast Market Abuse Directive (2003/6/EC) and its three implementing directives, expected to be adopted in June 2011
- Review of the Markets in Financial Instruments Directive (2004/39/EC) (commonly known as MiFID II), expected to be adopted in June 2011
- Amendments to the Capital Requirements Directive (2006/48/EC and 2006/49/EC) (CRD), expected to be adopted in June 2011 (The document also refers to a proposal to amend CRD as regards internal governance of credit institutions and investment firms in June 2011.)
- Legislative initiative on a framework for crisis management and resolution in the banking sector, expected to be adopted in June 2011
- A Regulation on central securities depositories, expected to be adopted in June 2011
- A Regulation amending the EU Regulation on credit rating agencies (1060/2009/EC), expected to be adopted in September 2011
- A legislative instrument on packaged retail investment products, expected to be adopted in the third quarter of 2011
- A Directive on mortgage credit, expected to be adopted in March 2011
- A Regulation on access to a basic payment account, expected to be adopted in May 2011

Read more.

For more information, contact:

FINANCIAL SERVICES

Janet M. Angstadt	312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	212.940.6615	henry.bregstein@kattenlaw.com
Guy C. Dempsey, Jr.	212.940.8593	guy.dempsey@kattenlaw.com
Daren R. Domina	212.940.6517	daren.domina@kattenlaw.com
Kevin M. Foley	312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	212.940.8525	jack.governale@kattenlaw.com
Maureen C. Guilfoile	312.902.5425	maureen.guilfoile@kattenlaw.com
Arthur W. Hahn	312.902.5241	arthur.hahn@kattenlaw.com
Joseph Iskowitz	212.940.6351	joseph.iskowitz@kattenlaw.com
Marilyn Selby Okoshi	212.940.8512	marilyn.okoshi@kattenlaw.com
Ross Pazzol	312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	312.902.5381	kenneth.rosenzweig@kattenlaw.com
Fred M. Santo	212.940.8720	fred.santo@kattenlaw.com
Marybeth Sorady	202.625.3727	marybeth.sorady@kattenlaw.com
James Van De Graaff	312.902.5227	james.vandegraaff@kattenlaw.com
Meryl E. Wiener	212.940.8542	meryl.wiener@kattenlaw.com
Lance A. Zinman	312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	312.902.5334	krassimira.zourkova@kattenlaw.com

LITIGATION

Julie Pechersky	212.940.6476	julie.pechersky@kattenlaw.com
Gregory C. Johnson	212.940.6599	gregory.johnson@kattenlaw.com

BANKING

Jeffrey M. Werthan	202.625.3569	jeff.werthan@kattenlaw.com
Christina Grigorian	202.625.3541	christina.grigorian@kattenlaw.com

UK/EU DEVELOPMENTS

Edward Black	44.20.7776.7624	edward.black@kattenlaw.co.uk

* Click here to access the *Corporate and Financial Weekly Digest* archive.

Katten

Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK WASHINGTON, DC

Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997).

London affiliate: Katten Muchin Rosenman UK LLP.